Inchbald, John

The price of money

London

1862

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Inchbald, John.
The price of money: the laws that regulate it, and the working of the Bank act, briefly explained. By John Inchbald ... 2d ed. London, E. Wilson, 1862.
24 p. 21cm.

VOLUME OF PAMPHLETS

1. Banking law - Gt. Brit. 2. Currency question - Gt. Brit.

Only Ed

TECHNICAL MICROFORM DATA

FILM SIZE: 35mm REDUCTION RATIO: 9:1 IMAGE PLACEMENT: IA IIA IB IIB

DATE FILMED: 3/27/98 INITIALS: F.C.

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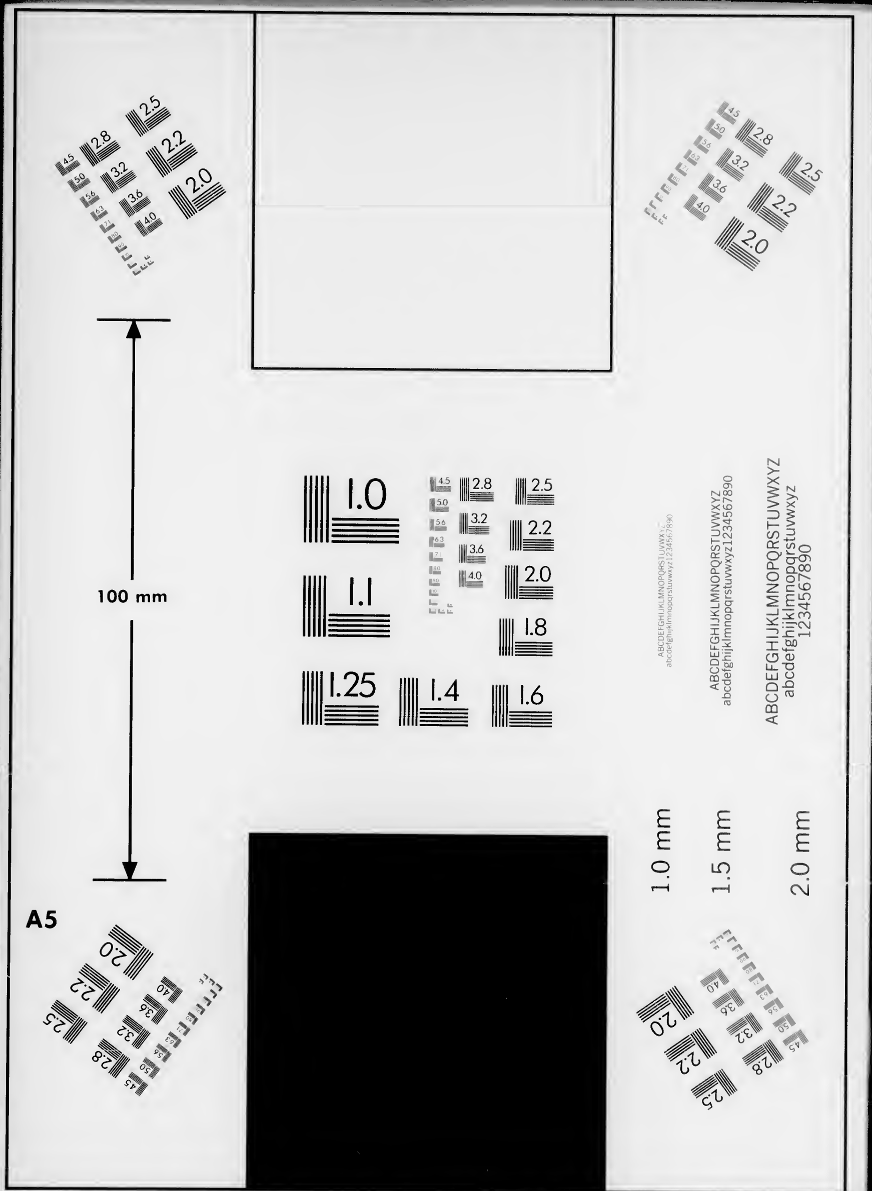
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THE

PRICE OF MONEY:

THE LAWS THAT REGULATE IT,

AND

THE WORKING OF

THE BANK ACT,

BRIEFLY EXPLAINED.

BY

JOHN INCHBALD,

OF THE STOCK EXCHANGE.

SECOND EDITION.

LONDON:

EFFINGHAM WILSON, ROYAL EXCHANGE.

1862.

ONE SHILLING.

PREFACE

TO THE

SECOND EDITION.

This pamphlet was written towards the end of the year 1857, and published in January, 1858. The anticipations expressed, that the period of extreme ease in the position of the money market would arrive in the natural course of events in 1862 (five years after the crisis of 1857), have been so exactly and remarkably fulfilled, that it induces the writer to issue another impression of the pamphlet, calling attention to this fact. Additional remarks will be found at the conclusion.

2, Copthall Court;
August, 1862.

THE PRICE OF MONEY;

AND THE BANK ACT.

The course proposed to be adopted in discussing our subject is, to show—

I. What the Act of 1844 enacts and effects.

II. The benefits arising from those enactments, with the reasons upon which they are founded.

III. To answer the objections generally urged against the Act.

IV. A further objection, in which we concur; the reasons for that concurrence, with a plan for obviating it.

V. Remarks upon monetary crises and periods of extreme monetary ease.

We may remark, that the figures given are all from Parliamentary and Official Papers.

It may not be out of place now, before proceeding further, to settle what is meant by the term *money*—this, of course, being a vital point in the question.

We accept the term *money*, as meaning only the *precious metals*—all paper money convertible into them representing them, as it were, as a shadow does the substance. They are that which is accepted by all nations of the world as a *universal equivalent*, and also as a *measure of value*. Whatever else any given parties

might agree among themselves to accept as a currency, would no doubt, act as an instrument of exchange between those parties; but what else is there, excepting the precious metals, which all parties, *at home and abroad*, agree to accept, in discharge of debts or balances of trade? In fact, every commercial transaction is made in them, on the one part, as representing the agreed equivalent.

It must, however, be carefully borne in mind that paper money, or Bank notes, as it is usually termed, immediately convertible into gold, being also a legal tender, and freely passing current from hand to hand, act with precisely the same effect in every respect as though they were so much more coin, in that country where they circulate. In other words, if there be in any country, say £20,000,000 of Bank notes circulating, and £20,000,000 of coin, the *effect* produced is the same as though it were £40,000,000 of gold or silver, in so far as it affects the value or depreciation of that currency.

Previous to entering further upon the subject in question, it may be well just briefly to explain the position of affairs *before* the passing of the Bank Act of 1844 (commonly called Sir Robert Peel's Act), which was simply this, that *no limit* by law was put upon the issue of notes either by the Bank of England, or country Banks in England, or Scotland, or Ireland, the only limit being that of the Bankers' own discretion, having regard to their liability at all times for the payment of the notes in gold on demand. The

Directors of the Bank of England might therefore be said, as it were, to have had the *custody* of the *legal tender* circulation of the country, subject only to their liabilities as Bankers.

I.

The Act of 1844, divides the business of "Issue" from that of "Banking," and makes them entirely separate departments of the Bank, as much so as if the *Issue* Department were managed by the Government itself. It further provides that the Issue Department shall issue but £14,000,000 of notes on Government Securities deposited with it, and that all further issues shall be on gold and silver coin or bullion only (the amount of silver being limited).

It also fixes the limit of issue of notes, upon a then average, of all the existing country Banks, and prohibits all new Banks or Bankers issuing any but Bank of England notes throughout England and Wales.

It however allows the Bank of England, under certain conditions, to issue further on Securities, to the extent of two thirds of all lapsed issues of country Banks in England. This power has been acted on to the extent of £650,000.

It therefore necessarily follows when the issue is above the £14,650,000 allowed on Securities (which is *always* the case), that whenever gold is withdrawn from the Bank, the notes so exchanged must be cancelled, thus reducing the note circulation by exactly the amount of

gold so withdrawn, by this means contracting the circulation to the same extent precisely as the Currency would be contracted if it consisted entirely of the precious metals; and when it is also borne in mind that the credit issues of the English Country Banks, as also those of the Scotch and Irish Banks, are rigidly fixed, it will be seen, almost at a glance, that the chief aim of the Legislature was to cause the amount of circulation or Currency in the country to fluctuate precisely as would a Currency consisting only of coin, in other words, a purely Metallic Currency.

Another aim, no doubt, was to secure, on strong grounds, the convertibility of the Bank note; that is made secure thus:—The lowest amount of notes in the hands of the public in modern times was in December, 1840, when it fell to £15,714,200; from this is deducted £1,000,000 for Bank Post Bills, and also £600,000 for lost notes since written off, leaving £14,114,200, so that it was safely assumed that the amount of notes required by the public could never fall below £14,000,000, and all beyond being issued only on deposit of gold, the convertibility of *all* notes that *could* be expected to come in for gold is considered to be satisfactorily secured.

We now come to the science or principles of currency, upon which the Act proceeds:—The grand cardinal principle regarding the currency, on which the Act of 1844 is based, and which it appears impossible to controvert, is simply this, that the supply of money, like any other commodity, in a country, must and will be regulated by

the price or value it bears in that country, as compared with the price and value it bears in other countries; that is, of course, after making due allowance for differences in the standing and credit, and of the stability of the governments of the respective countries. In other words, if there be such an overplus supply of gold in any given country as that its equivalent value becomes *depreciated in that country*, as compared with its equivalent value in *other* countries, so that, allowance being made for risks and costs of transmission, it can be more profitably employed in another country, it will, by the natural laws of supply and demand, be exported from the country where it is *cheap*, to that where it is *dear*.

As a matter of course, in a country where money is *dear*, the prices of interest-bearing securities, and all property, together with all kinds of produce, must be proportionately lower (*cæteris paribus*) than in a country where money is *cheap*, which naturally leads merchants and others to sell these things in the cheap money country, and export the proceeds in gold, to be invested in the securities, &c., of the *dear* money country; and by reselling again in the cheap money country, this process must go on until the enhanced price of money in that country brings about such a condition of prices therein as puts an end to the profits of the operators, and so to the export of gold—now let it be conceived, that while this process is going on, the *cheap money* country were to go on issuing *paper* money to fill the void occasioned by the gold sent away, thus keeping

the price of money therein *low*, it must go on till the reduced amount of gold in its banks leads to alarm and a run for it in exchange for their notes, and a general suspension of payments occurs, such as was recently witnessed in the United States of America.

As further examples of the truth of this argument, we might take the case of wheat, sugar, or any other article of commerce, but perhaps diamonds are a more analogous commodity to take. Supposing, then, all countries to have a certain sufficient supply of these precious stones, according to their respective wants, so that the value of them in each should be nearly the same, and supposing that into one of these countries a sudden extra supply was to be poured, the price would of course fall, in proportion to the extent of that extra supply, until it bore an unduly low proportion to the price in the other countries, and the consequence would be that a portion of them would be exported from that country to other countries, and that they would continue to be so exported until the remaining *reduced* quantity should rise in value equal to the value maintained in the other countries; and a similar process must naturally take place as regards the precious metals themselves. This, then, is the precise process which is brought about by an over-issue of paper money in a country. Currency in that country becomes unduly *depreciated*, as compared with the currency of other countries, and is consequently sent abroad; and if such over-issue goes on long enough, inasmuch as foreign nations will only receive the *gold*,

and not the *paper*, of that country, it may be entirely drained of its gold, and be then left to settle its balances with other nations as best it can.

As further proof of the soundness of this cardinal doctrine of Currency, we give the following extracts from the evidence given by Lord Overstone, before the Select Committee on Bank Acts of the House of Commons, in 1857; he quotes from Mr. M'Culloch, who says, " When " a Currency consists partly of the precious metals, and " partly of paper immediately convertible into them, " any over-issue of the latter depresses not merely the " value of the paper money, but of the coins which cir- " culate along with it. Those coins, therefore, are imme- " diately converted into bullion or exported. The ulti- " mate effect of an over-issue of paper in a country " whose Currency consists partly of coin, is an exporta- " tion of coin, or of bullion formed out of the coin." Lord Overstone then goes on to say,—" These principles " are perfectly obvious. They are the very elements of " science on this subject," &c. And, further on, he says, " I quote another very short passage from Mr. M'Culloch again:—' When the Currency of any particular " ' country, as of England, consists partly of the precious " ' metals and partly of paper convertible into them, the " ' effects produced by an over-issue of paper are the " ' same as those resulting from an over-issue of gold or " ' silver. The excess of paper is not indicated by a " ' depreciation or fall in the value of paper as compared " ' with gold, but' (and these words are in *italics* in his

"'own book) 'by a depreciation in the value of the "'whole Currency, gold as well as paper, as compared "'with that of other states.'" Lord Overstone himself continues—"Without a full and clear understanding "of that principle, it is impossible to understand any "part of this subject. Convertible notes may be issued, "continually depreciating the Currency, until the metallic "portion of the Currency has been entirely banished from "the country; and then the notes, now become inconvertible, may be further issued until all the transactions of "society have been brought to a state of utter confusion."

To recapitulate: the Act of 1844, then, it is seen—

Divides the Bank of England into an Issue Department and a Banking Department;

Limits its Issue upon Securities;

Limits the Issues of Country Bankers; and

Prohibits any new Bank of Issue from commencing.

The Act of 1845, a supplement to that of 1844, fixes and limits the issues of the Scotch and Irish Banks (on an average at the time), without deposit of bullion, but allowing them to issue to any further required amount, on *the deposit of gold* against the extended issues.

II.

The benefits arising from these enactments:—That *the Currency of this country is prevented from becoming permanently depreciated by a mere over-issue of notes*, as compared with the Currencies of *other* countries, because as soon as any serious redundancy of circulation arises

to affect the exchanges and to cause gold to leave the country, the evil immediately commences to correct itself, by the notes for the exported gold being cancelled, thus causing what remain to become more scarce and valuable; and so tending to raise the Currency to the standard of the value of the Currencies of those countries whither it was flowing.

The benefit arising from the limit put upon the issues of Country Banks is, that it prevents them from counteracting, *by their issues*, the effect of a curtailment of the issues of the Bank of England when a drain of gold sets in. This it was found they did, both previous to the crisis of 1825 and also that of 1837-9. It proved to be a most grievous evil, and one that it was absolutely necessary to prevent for the future.

The amounts of Issue allowed by the Acts of 1844 and 1845, *without the deposit of a single sovereign*, were—

Bank of England		£14,000,000
English Country Banks—		
Private	£5,011,107	
Joint Stock . . .	3,477,321	
		£8,488,428
Scotch Banks		3,087,209
Irish Banks		6,354,494
TOTAL		£31,930,131

a pretty considerable number of "promises to pay" sovereigns, it must be admitted, without the requirement, by *law*, of a *single one* being in hand to meet them:

and the fact should never be lost sight of, that it is not merely their *notes* which all Banks are liable to pay in gold, but also the enormous and vast amounts of their *Deposits*, if so called for.

Another benefit of this Act is, that by fixing the amount of Issues of the Bank on Securities at a somewhat low figure, it prevents, in times of any severe drain, the gold in the coffers of the Bank from falling to an unreasonable or dangerously low amount; but this question will be referred to again below.

III.

We now come, thirdly, to some of the *objections* urged against the Act of 1844. One is—That the price of gold is fixed by it; it being alleged that it is unnatural so to fix it. Another—That the fixed issue of £14,000,000 on Securities is too small, if a limit is to be fixed at all.

With regard to the first objection, that the price of gold is fixed by the Act, at the rate of £3 17s. 9d. the ounce, it is conceived that it is simply a delusion to suppose the Act fixes, in any sense of the word, the price of gold; all that it does in this respect is to require the Bank of England to give notes for gold of a certain standard value, at the rate of £3 17s. 9d. for the ounce, and to return the same for the notes, when coined, at the rate of £3 17s. 10½d. for the ounce, the small difference of three halfpence per ounce being allowed for the risk and expense of coining the same.

The *value* of gold, as regards all other commodities, is the quantity of each that the ounce, or any other portion, will exchange for from time to time. The *price* of gold (or money) is measured by the *rate of interest* which must be paid for the use of it from time to time.

With regard to the second objection, that the amount of issue allowed on Securities is too small, it does not appear to be so, and for the following reasons:—If the £14,000,000 were raised, say to £16,000,000; during the time of a drain of gold from this country, owing to adverse exchanges, the further £2,000,000 of notes would only be exchanged for gold to be sent abroad, and would consequently be *cancelled*, leaving us with the *same* amount of notes in circulation, but with £2,000,000 less of gold; then the question arises, Should we not have a sufficient amount of gold when the further £2,000,000 *had* gone? In reply to this, it must be borne in mind that the Bank is the great centre for deposits of gold, and has to meet in times of pressure and alarm a call for coin on behalf of every Country Bank in England, as also on behalf of all the Scotch and Irish Banks, in case of a run upon them, as we witnessed during the crisis of 1857; and had it not retained, through the working of this Act, a considerable amount of bullion, a general run might have supervened upon the Bank itself for gold for its notes, and thus inevitably have led to a suspension of specie payments. As it was, after the issue of the Government letter of the 12th November (1857), owing to the serious call for gold to supply the

Scotch and Irish Banks, the total amount of bullion held by the Bank fell on the 17th November to £6,321,000, with notes out at the moment for £21,407,000; now, had this drain commenced with £2,000,000 less of bullion to work upon, the amount remaining would only have been £4,321,000 against the £21,407,000 notes!

It may be well here to call attention to the dangerously low points to which the bullion held by the Bank arrived in the different crises which occurred *previous* to the passing of this Act, as compared with the lowest point it touched under the Act in 1847 and 1857.

In the crisis of 1825, the bullion in The Bank fell as low as	£1,100,000
In that of 1837 to	3,831,000
In 1839 to	2,406,000
In 1847 (under this Act) to	8,313,000
In 1857 ,, to	6,974,000
Do. (after suspension of the Act) to .	6,321,000

In 1839 the Bank was obliged to make arrangements with the Bank of France, which were equivalent to a supply of about £2,000,000 of gold—a circumstance not very flattering to the credit of this country.

IV.

We now turn to the fourth division of our subject, which deals with an objection to the Act of 1844 in which we must concur, or, perhaps we should rather say, an omission in the Act, than an objection to it:

it is this—that when a time of pressure and consequent alarm *has* arisen (whether as a consequence of an *external* or *internal* drain of gold, a state of discredit, or an unreasoning panic), and reduced to a low point the Bank reserve of notes, the mere fact of there being a *fixed limit* to the note issue at all, does most undoubtedly aggravate and increase the evil, and that in no moderate or slight degree. And as the alarm progresses, causing every one under pecuniary liabilities to seek to provide a supply of money to the full extent he is likely to require, and a reserve, probably, even beyond that in case of need, it acts and reacts upon itself, by thus causing the Reserve of the Bank to fall lower and lower, until it arrives at a point which induces many persons to withdraw their money on deposit at call in the Joint Stock Banks and Discount Houses, which leads not only to the putting a stop to the power of these Banks to discount, but probably obliging them also to seek for temporary assistance from the Bank of England; thus leading to calls upon it which its diminished amount of reserve is by no means able to answer; then comes a suspension of the Act, and the alarm rapidly ceases.

In confirmation of this, the following extract is given from the speech of the then Chancellor of the Exchequer on the subject, in the House of Commons, on the 4th of December, 1857. He is reported to have spoken as follows: (*see* 'Times' report)—

"Now, with respect to the operation of the Act of 1844, I am "desirous of drawing the attention of the Committee to the dis-

"tinction between the ordinary operations of the Act in those "circumstances which were contemplated by its authors, and its "operations at a moment of panic or crisis. If we take its ope- "rations under ordinary circumstances, the limit imposed on the "Bank of England, and on the country banks, and on Irish and "Scotch banks, operates in the way of prevention. It does not "check the ordinary habitual operations of commerce, but it is "like a punishment in the penal law, which, by its preventive "consequences, determines men's conduct. But when we come to "a state of panic, all these circumstances are reversed. Men's "minds are then in an extraordinary state. Mutual distrust "prevails through the community, and a law which may be per- "fectly suited to the ordinary conditions of trade, in which it may "operate beneficially when men are left under the influence of "ordinary motives, may, at a time of panic, be found to produce "effects the reverse of beneficial. The question then arises "whether some extraordinary power should not be required to "suspend the operation of such a law. The present law does two "things It imposes a limit on the issue of the Bank of England, "and exhibits the accounts of the Bank of England in a peculiar "form, and likewise requires that those accounts should be pub- "lished once a week. Now, wherever you impose a limit, there is "no question that the existence of that limit, provided it makes "itself felt at a moment of crisis, must increase the alarm. People "feel at the moment that a peril presses on them; they begin to "calculate how much remains of that fund to which they look for "assistance in times of commercial difficulty; and in whatever "way you fix the limit, whether by Act of Parliament, or, as Mr. "Tooke proposed, by a sort of usage, or, as in France, by the dis- "cretion of the Government acting on the Bank of France, there "is no doubt that in moments of crisis the limit must aggravate "the alarm. (Hear, hear.) I can bear witness, from my own ob- "servation, that such was its operation in 1847. There is no "doubt, in my opinion, that when a crisis once sets in, when you "have an extraordinary state of distrust quite different from the

"state in which men ordinarily live (because it is by mutual trust "and confidence that commerce is carried on), when you get into "a state of apprehension, and every man suspects his neighbour, "then undoubtedly any limit, which is imposed on the paper cir- "culation, must aggravate the alarm. In that way I distinguish "between the ordinary and the extraordinary operation of this Act. "(Hear, hear.)"

Mr. G. C. Glyn, M.P., the eminent Banker, is also reported to have said—

"With respect to the other point—the limitation of the circu- "lation to £14,475,000,—there he confessed he found the great "difficulty of the question to lie. He thought no person who had "watched the progress of the crisis in 1847, and again in 1857, "could fail to arrive at the conviction, that, although the pressure "was not caused by the Act, yet, the pressure existing, the limi- "tation of power to issue upon securities became in itself a pri- "mary cause of evil. (Hear, hear.)"

The accuracy of these opinions is conclusively proved by the fact, that the amount of notes of the Bank of England, in the hands of the public for several days during the height of the pressure in 1857, averaged upwards of £21,500,000, whereas the amount with the public in ordinary times seldom exceeds £19,000,000, or £19,500,000, clearly showing that the pressure did not arise from any absolute *want* of notes for the usual requirements of the country, as the supply in the hands of the public is thus shown to have been actually £2,000,000 above the average ordinary amount; thus proving that from fear, discredit, or hoarding, the notes out were not effecting their usual circulating duty.

If it be required further to show the necessity for some provision in the Act against panic, it should be borne in mind that if, on a state of panic having supervened, only 20,000 people (a very small portion out of the population of England, say 20,000,000) were to hoard the amount of £1000 each in Bank of England notes, it would absorb the *entire* average circulation of that establishment, and so bring to a perfect stand-still the circulation of its notes. Now, as at such times the notes of the Country Banks are liable to become more or less discredited, and fall out of use, this is not such an unreasonable hypothesis as at first sight it may appear. The *immediate* effect, also, of the letters of the Government to the Bank in each instance (1847 and 1857), in so greatly relieving the money market, must be convincing evidence to any unprejudiced mind, that the previously existing state of things arose, in great measure, from panic and alarm on the part of the commercial community, lest Bank notes might not be had on any terms to meet their current engagements; and such a condition existing, people are no longer guided by the ordinary instincts of reason, but act under the control of *un*reasoning fright.

The question then arises, in what manner provision may be made in the Act to meet these occasions of monetary pressure, which it appears occur from time to time at stated periods, and that apparently as certainly as the natural ebb and flow of the tide. Such pro-

vision may be made (and that without in the slightest degree interfering otherwise with the principles of the Act), by the addition of a clause giving the power to the Court of Directors of the Bank, when circumstances arise sufficiently urgent, in their discretion, to call for it, to increase the issue of notes upon securities to such extent, and in such manner, as they may deem fit; and, as a protection against any indiscreet or unnecessary relaxation of the Act, a proviso might be added, that this increased issue should require the approval or sanction of the First Minister and Chancellor of the Exchequer of the day; such a power would meet the difficulties of the case, and when required to be exercised, would be merely a *carrying out of the law,* in place of an absolute *breaking* of it, as at present occurs, much, no doubt, to the discredit and injury of this country in the eyes of foreign nations and their merchants.

If it be thought that this power of further issue should not rest with the Bank Directors, it might be lodged with the First Minister and the Chancellor of the Exchequer of the day, it matters not which, so long as it *does* exist, in order both to act as a preventive of panic or wild alarm at a time of monetary pressure, and in order that, when the necessity of exceeding the fixed issue occurs, there may exist the power of allowing it *legally,* and without a breach of the law, followed by the summoning of Parliament, as in 1847 and 1857, to grant a Bill of Indemnity to the Bank, on account of the Government having advised it *to break the law of the land.*

V.

In conclusion, we would add a few remarks upon the great *decennial* monetary crises which have come upon this country with remarkable regularity, for the last hundred years, and which there appears every reason to believe will continue to occur at future similar, or it may be shorter, periods of time. The first one which we find chronicled occurred in the year 1783, the next in 1793 (that of 1797 arose from political alarm and a fear of foreign invasion, when the Bank of England suspended specie payments, which continuing till 1819, the crises in this period are not observable)—then comes the severe one of 1825, followed by those of 1837, 1847, and 1857.

The course of these events appears to be marked by clear and defined steps, as follows:—At the period of a crisis the price of money is greatly enhanced, prices of securities and all property fall, trade is curtailed, and imports restricted to the utmost, which, by favorably affecting the exchanges, causes the stream of bullion to set into this country—the gold in the Bank coffers, with some intermissions, gradually increases (the rate of discount, meanwhile, falling with more or less regularity), until, at the end of about five years after the crisis the amount of gold in the Bank reaches its *maximum;* the rate of interest falling to about two per cent. A period of rampant speculation, and over-trading then commences, resulting in extremely high

prices, which lead to increased importations, and again turn the balance of trade and the exchanges against us; the bullion then commences to flow out, to meet the adverse balance of trade, and the rate of interest to rise step by step, with more or less regularity, through another period of about five years, until a crisis is again brought about, and the current of gold is again turned inward through the same means as above stated.

For an example of this, take the period from 1847 to 1857. The crisis of 1847 reduced the bullion in the Bank to £8,313,000; the flow of bullion then set in, and continued till 1852 (five years), in July of which year it reached its *maximum* amount in the Bank, and stood at £22,232,000; the Bank rate of discount having fallen in the mean time from *eight* per cent. (in 1847) to *two* per cent. in 1852. Speculation, over-trading, high prices, and increased importations, then turned the balance of trade and the exchanges against us; a drain of gold commenced, and went on, with a few periods of intermission, till the crisis of 1857, during which the bullion in the Bank reached a minimum of £6,321,000, and the rate of discount a maximum of *ten* per cent. The tide has again turned, the current of bullion is flowing in, and the rate of discount is rapidly falling.

This pamphlet, as stated in the preface, with the exception of a few trifling corrections, was published in January, 1858, and the decennial period of extreme ease

in money has arrived, as we herein anticipated, with very remarkable exactness, the Bank rate of discount, on account of the continued influx of gold, having been made 2 per cent. on the 24th July, 1862, it never having been put at this low figure since the 22nd April, 1852—the previous *decennial* period—and this is the more remarkable, inasmuch as upwards of £21,000,000 sterling of Foreign loans have been negociated, chiefly in London, since the commencement of this year. This condition of extreme monetary ease will, there appears every reason to believe, produce similar effects as did the same causes in 1852; and by 1867 this country will most probably have to pass through a severe monetary crisis and panic, as in 1847 and 1857. We are speaking, of course, only of the *ordinary* course of events, and allowances must be made for the extraordinary events of war or deficient harvests, should the country have to pass through such trials.

The Foreign Government loans negociated, and being negociated, chiefly in this country, in the course of the present year (1862), already amount to upwards of £38,000,000 nominal capital, requiring in actual money about £30,500,000—an ominous feature for the future of our money market.

LONDON: PRINTED BY EFFINGHAM WILSON, ROYAL EXCHANGE.

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